

PUBLIC PROTECTION CABINET
Department of Financial Institutions
(Amended at ARRS Committee)

808 KAR 10:440. Examples of dishonest or unethical practice for broker-dealers and agents.

RELATES TO: KRS 292.337, 292.480

STATUTORY AUTHORITY: KRS 292.336(7), (8), 292.337, 292.500(3)

NECESSITY, FUNCTION, AND CONFORMITY: KRS 292.500(3) authorizes the commissioner of the Department of Financial Institutions to promulgate administrative regulations necessary to carry out the provisions of KRS Chapter 292. KRS 292.336(7) and (8) authorize the commissioner to promulgate administrative regulations prohibiting unreasonable charges, profits, commissions, or other compensation for broker-dealers and agents and prescribing standards for the conduct of business by broker-dealers and agents which the commissioner finds appropriate in the public interest and for the protection of investors. This administrative regulation establishes requirements concerning dishonest and unethical practices by broker-dealers and agents and states the consequences of engaging in unacceptable conduct or practices.

Section 1. Broker-dealers shall observe high standards of commercial honor and just and equitable principles of trade in their dealings with customers and the conduct of their business. The following acts and practices shall constitute violations of those standards and principles and shall be considered to be dishonest and unethical practices that may result in a fine, suspension, or revocation in proportion to the seriousness of the offense, pursuant to KRS 292.337(1):

- (1) Engaging in a pattern of unreasonable and unjustifiable delays in the delivery of securities purchased by any of its customers or in the payment of free credit balances reflecting completed transactions of any of its customers;
- (2) Failing or refusing to furnish a customer, upon reasonable request, information to which the customer is entitled, or to timely respond to a formal written demand or complaint by a customer;
- (3) Attempting to enforce a condition, stipulation, or provision against a customer in Kentucky if the result would:
 - (a) Leave the customer without the choice of a forum for dispute resolution in the state of Kentucky; or
 - (b) Limit the timeliness of an action to a period less than that established in KRS 292.480;
- (4) Failing to segregate a customer's securities held in safekeeping;
- (5) Hypothecating a customer's securities without having a lien thereon unless the broker-dealer secures from the customer a properly executed written consent promptly after the initial transaction, except as permitted by rules of the Securities and Exchange Commission;
- (6) Charging unreasonable and inequitable fees for services performed, including:
 - (a) Collection of monies due for principal;
 - (b) Dividends or transfer of securities;
 - (c) Appraisals;
 - (d) Safekeeping; or
 - (e) Custody of securities and other services related to its securities business;
- (7) Offering to buy from or sell to any person any security at a stated price unless the broker-dealer is prepared to purchase or sell at the price and under the conditions as are stated when the offer is made;

- (8) Representing that a security is being offered to a customer "at the market" or a price relevant to the market price unless the broker-dealer knows or has reasonable grounds to believe that a market for the security exists other than that made, created, or controlled by the broker-dealer, or by any person for whom the broker-dealer is acting or with whom the broker-dealer is associated in the distribution, or any person controlled by, controlling, or under common control with the broker-dealer;
- (9) Failing to disclose in writing that the broker-dealer is controlled by, controls, is affiliated with, or is under common control with the issuer of any security, the existence of this control before entering into any binding contract with or for a customer for the purchase or sale of the security;
- (10) Failing to make a bona fide public offering of all the securities allotted to the broker-dealer for distribution, whether acquired directly as an underwriter or a selling group member or indirectly from an entity participating in the distribution as an underwriter or selling group member;
- (11) Inducing trading in a customer's account which is excessive in size or frequency in view of the financial resources and character of the account;
- (12) Switching, churning, overtrading, or reloading of a security in a customer's account for the purpose of accumulating or increasing a commission;
- (13) Recommending to a customer the purchase, sale, or exchange of any security without reasonable grounds to believe that the transaction or recommendation is suitable for the customer based upon a reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer;
- (14) Failing to furnish to a customer purchasing securities in an offering, no later than the due date of confirmation of the transaction, either a formal prospectus or a preliminary prospectus and an additional document, which together include all information set forth in the final prospectus;
- (15) Participating in the solicitation or offer for sale of a security without the use of an offering document or prospectus, if required, or making a statement contrary to or inconsistent with disclosure contained in the offering document or prospectus;
- (16) Making a false, misleading, deceptive, or exaggerated representation or prediction in the solicitation or sale of a security, including:
- (a) That the security will be resold or repurchased;
 - (b) That the security will be listed or traded on an exchange or established market;
 - (c) That the security will result in an assured, immediate, or material increase in value, future market price, or return on an investment;
 - (d) That there is a guarantee against risk of loss; or
 - (e) Any statement with respect to an issuer's financial condition, anticipated earnings, potential growth, or success not supportable by information in the offering document or prospectus;
- (17) Engaging or aiding in boiler room operations such as the use of high pressure tactics to promote a speculative offering or promotion of a security in an intensive campaign in which the prospective purchaser is encouraged to make a hasty decision to buy a security irrespective of the purchaser's investment needs, objectives, or understanding of the security being offered;
- (18) Executing a transaction on behalf of a customer without authorization to do so;
- (19) Exercising any discretionary power effecting a transaction for a customer's account without first obtaining written discretionary authority from the customer, unless the discretionary power relates solely to the time or price for the executing of orders;
- (20) Executing any transaction in a margin account without securing from the customer a properly executed written margin agreement;

- (21) Entering into a transaction with or for a customer at a price not reasonably related to the current market price of the security or receiving an unreasonable commission or profit;
- (22) Effecting any transaction in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive, or fraudulent device, practice, plan, program, design or contrivance, including:
- (a) Effecting any transaction in a security which involves no change in the beneficial ownership;
 - (b)
 - 1. Entering an order or orders of substantially the same size, time, and price, for the sale of any security that has been or will be entered by or for the same or different parties for the purpose of creating a false or misleading appearance:
 - a. Of active trading in the security; or
 - b. With respect to the market for the security.
 - 2. This subsection shall not prohibit a broker-dealer from entering bona fide agency cross transactions for its customers; or
 - (c) Effecting, alone or with one (1) or more other persons, a series of transactions in any security creating actual or apparent active trading in the security or raising or depressing the price of the security, for the purpose of inducing the purchase or sale of the security by others;
- (23) Guaranteeing a customer against loss in any securities account of the customer carried by the broker-dealer or in any securities transaction effected by the broker-dealer;
- (24) Publishing or circulating, or causing the publication or circulation of, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which purports to:
- (a) Report any transaction as a purchase or sale of any security unless the broker-dealer reasonably believes that the transaction was a bona fide purchase or sale of the security; or
 - (b) Quote the bid price or asked price for any security, unless the broker-dealer reasonably believes that the quotation represents a bona fide bid or offer;
- (25) Using any advertising or conducting any sales practice in a deceptive or misleading manner;
- (26) Entering into an agreement for a concession, discount, commission, or allowance as consideration for a service in connection with the distribution or sale of a security in Kentucky with a broker-dealer, agent, investment adviser, or investment adviser representative who is not either:
- (a) Registered in Kentucky; or
 - (b) Exempted from the registration requirements for conducting a securities business in Kentucky;
- (27) Lying to or otherwise misleading representatives of the Department of Financial Institutions conducting an authorized examination or investigation;
- (28) Failing to make requested records available to or otherwise impeding a representative of the Department of Financial Institutions conducting an authorized examination or investigation;
- (29) Failing to respond within the specified time period to a written request from an authorized representative of the Department of Financial Institutions for:
- (a) Information;
 - (b) An explanation of practices or procedures;
 - (c) A response to a complaint filed with the Department of Financial Institutions; or
 - (d) A response to a written statement of findings from an examination;
- (30) Committing any act involving a customer, a customer's account, or any business records which would constitute a criminal offense;

(31) Failing to pay and fully satisfy any final order, final judgment, or arbitration award resulting from an investment-related, customer-initiated arbitration or court proceeding, unless:

(a) There is a written agreement for alternative payment arrangements between the customer and the broker-dealer or broker-dealer agent; and

(b) The broker-dealer or broker-dealer agent complies with the terms of the alternative payment arrangement;

(32) Attempting to avoid payment of any final order, final judgment, or arbitration award resulting from an investment-related, customer-initiated arbitration or court proceeding, unless:

(a) There is a written agreement for alternative payment arrangements between the customer and the broker-dealer or broker-dealer agent; and

(b) The broker-dealer or broker-dealer agent complies with the terms of the alternative payment arrangements; or

(33) Failing to pay and fully satisfy any fine, civil penalty, order of restitution, order of disgorgement, or similar monetary payment obligation imposed upon the broker-dealer or agent by the Securities and Exchange Commission, the securities or other financial services regulator of any state or province, or any self-regulatory organization.

Section 2. Broker-dealer agents shall observe high standards of commercial honor and just and equitable principles of trade in their dealings with customers. The following acts and practices shall constitute violations of those standards and principles and shall be considered to be dishonest and unethical practices that may result in a fine, suspension, or revocation in proportion to the seriousness of the offense, pursuant to KRS 292.337(1):

(1) Sharing in profits or losses in the account of a customer without the written authorization of the customer and the broker-dealer which the agent represents;

(2) Establishing or maintaining an account containing fictitious information in order to execute transactions which would otherwise be prohibited;

(3) Effecting securities transactions not recorded on the regular books and records of the broker-dealer which the agent represents, unless the transactions are authorized in writing by the broker-dealer prior to execution of the transaction;

(4) Engaging in the practice of lending to or borrowing from a customer either money or securities;

(5) Acting as custodian of a customer's money, securities, or an executed stock power; or

(6) Engaging in conduct specified in Section 1(11) through (33) of this administrative regulation.

Section 3. Issuer agents shall observe high standards of commercial honor and just and equitable principles of trade in their dealings with customers. The following acts and practices shall constitute violations of those standards and principles and shall be considered to be dishonest and unethical practices that may result in a fine, suspension, or revocation in proportion to the seriousness of the offense, pursuant to KRS 292.337(1):

(1) Engaging in conduct specified in Section 1(2), (13), (15) through (18), or (25) through (33) of this administrative regulation; or

(2) Engaging in conduct specified in Section 2(3) or (4).

Section 4. The commissioner may determine that an activity not included in the examples identified in Sections 1 through 3 of this administrative regulation constitutes a dishonest or unethical practice if the activity is similar to an enumerated activity.

(35 Ky.R. 1108; Am. 1775; eff. 2-6-2009; 37 Ky.R. 2500; 2847; eff. 7-1-2011; Cert eff. 2-27-2020; 49 Ky.R. 1676, 21000; eff. 8-1-2023.)

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